SUMMARY of COOPERATIVE CASES

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

TREATMENT BY FARMERS OF PATRONAGE DIVIDENDS RECEIVED IN NONCASH FORM

The 1959 edition of "Farmers' Tax Guide," Publication No. 225 of the Internal Revenue Service, now available to farmers throughout the country through the offices of Agricultural Extension Agents and local Internal Revenue officers contains on page 25 this paragraph:

> "Patronage dividends
>
> "In general, any patronage dividends which you receive from a cooperative are includible in your income in the year received. The amount to be included in your income in respect of such dividends is measured by the amount of cash received plus the fair market value of any other property received. However, if the dividends are in document form, such as certificates of indebtedness, revolving fund certificates, or stock certificates, which have no fair market value and over which you have no control as to the amount or time of their redemption in cash or other property, they are not included in your income until they become subject to payment on your demand -- regardless of your accounting method. Dividends you receive as a result of purchases of capital assets, or depreciable property used in your business, which would otherwise be taxable under the above rule, are not included in your income, but the purchase price or basis of such assets must be reduced accordingly. Patronage dividends you receive on nonbusiness purchases are not included in your income."

This is the first published release by the Internal Revenue Service attempting to clarify or spell out in any way the principle to be followed in connection with the new tax treatment "of allocations of patronage dividends by cooperative associations to its patrons," as referred to in Technical Information Release #69 of February 14, 1958, by the Internal Revenue Service.

Although this information bulletin does not have the legal effect of regulations, it purports to set forth policies already established by the Internal Revenue Service. Regulations are in process, and will be issued first in tentative form in the Federal Register, to afford interested parties at least 30 days in which to present their comments and recommendations. Accordingly, cooperatives may wish to be on the lookout for this tentative publication. (For tentative regulation as published see page 18.)

ALLOCATION OF PATRONAGE DIVIDENDS: TRANSACTIONS WITH NONMEMBERS; EQUITABLE ALLOCATION.

(Pomeroy Cooperative Grain Co. v. Commissioner, 31 T. C. , No. 71; CCH. Dec. 23, 302 (1958)).

This case is one of the Iowa grain cases involving primarily the question as to the tax treatment by a nonexempt cooperative of net margins on business done with or for an agency of the United States Government. The Tax Court sustained the Commissioner and held that margins on this business are subject to tax and cannot be excluded from gross income as part of the "patronage dividends" allocated to members of the cooperative.

The taxpayer is an Iowa corporation, which was organized and operated under the Iowa cooperative marketing law (Chapter 499 of the Codes of Iowa, 1950 and 1954). It did not qualify (which it conceded) under section 101(12) of the 1939 Code, or section 521 of the 1954 Code, for the special tax treatment there provided. Accordingly, it was taxable on all receipts except such amounts as might properly be excluded from "gross income" for tax purposes as patronage refunds.

Part of the cooperative's activities consisted of buying and selling grain. It also performed various services related to the handling, storing and conditioning of grain. Grain was received by the taxpayer in three ways: (1) by purchase from producers, including both members and nonmembers, at the time of delivery of the grain at its elevator; (2) by delivery from producers, including both members and nonmembers, in satisfaction of crop loans theretofore made to them by the Commodity Credit Corporation - and this grain was thereafter handled and in some instances stored by taxpayer on behalf of the Government agency which became the owner of such grain at the time of its delivery at taxpayer's elevator; (3) by delivery from persons other than Commodity Credit Corporation (including both member and nonmember producers and by three business organizations which were neither members nor producers), for storage on behalf of these parties who owned the grain.

During the taxable years 1953-55, the taxpayer allocated patronage dividends to its members only, out of compensation received for its services in connection with grain received under circumstances (2) and (3) above. The net margin on the sales activity under (1) above was adjusted to exclude the proportion attributable to nonmembers and only the remainder

distributed to members, so no question was raised on item (1). However, the Commissioner determined that the amounts allocated under (2) and (3) did not qualify as true patronage dividends and therefore were not excludable from taxpayer's income.

The court agreed with the Commissioner. It ruled that the compensation received from the Commodity Credit Corporation for services in handling and storing Government-owned grain, and the compensation received from nonmember persons and nonmember business organizations could not be classified as receipts realized from transactions with the particular patrons for whose benefit the allocations were made, a prerequisite to their being included in a true patronage refund distribution. However, the court said that amounts allocated to members only, out of compensation received from members for storing grain owned by them, were excludable from taxpayer's gross income, <u>but only to the extent</u> that the amounts which were <u>allocated to the particular members who stored grain represented their proportionate shares of total member storage business which produced the compensation of such class, less the necessary expenses applicable thereto.</u>

The court recognized that the Iowa code required distribution to "members" only, but said, of course, that Federal law governed the disposition of this case. It continued:

"Neither the 1939 Internal Revenue Code nor the 1954 Code provides specifically for the exclusion or deduction of patronage dividends, refunds, or rebates, by a non-tax-exempt cooperative. However, it has been the administrative practice of the Treasury Department and its Internal Revenue Service, for many years, to exclude true patronage dividends of non-exempt cooperatives, under certain conditions. I.T. 1499, I-2 C.B. 189, 191 (1922); A.R.R. 6967, III-1 C.B. 287 (1924); S.M. 2595, III-2 C.B. 238 (1924); G.C.M. 12393, XII-2 C.B. 398 (1933); G.C.M. 17895, 1937-1 C.B. 56; I.T. 3208, 1938-2 C.B. 127; Rev. Rul. 57-59, 1957-1 C.B. 24. And such administrative practice is recognized, at least indirectly, both in section 101 (12)(B) of the 1939 Code and in section 522(b)(2) of the 1954 Code, wherein it is stated: 'Patronage dividends, refunds, and rebates to patrons with respect to their patronage * * * shall be taken into account in computing net income [of an <u>exempt</u> cooperative] in the same manner as in the case of a cooperative association not exempt * * *.'

"The propriety of such administrative practice in allowing exclusions for patronage dividends to non-exempt cooperatives, in the absence of any specifically expressed statutory authority,

was questioned by the Court of Appeals for the Ninth Circuit in Cooperative Oil Association, Inc., v. Commissioner, 115 F. 2d 666, affirming a Memorandum Opinion of this Court. However, the Treasury Department and its Internal Revenue Service have adhered to such practice, on the theory that true patronage dividends are, in reality, either (a) additions to the prices initially paid by the cooperative to its patrons for products which the patrons had marketed through the cooperative, or (b) refunds to patrons of part of the prices initially paid by them for merchandise or services which they had obtained through the cooperative. Thus, the administrative practice is to treat true patronage dividends as corrective and deferred price adjustments, which serve to reduce the amount of the cooperative's gross profit from sales, and which actually never became part of its gross income. I. T. 3208, supra, 128. This administrative practice, and the theory on which it is based, have been recognized and approved by this and other courts. Clover Farm Stores Corporation, 17 T.C. 1265, 1277; Dr. P. Phillips Cooperative, 17 T.C. 1002, 1010; United Cooperatives, Inc., 4 T.C. 93, 106; Midland Cooperative Wholesale, 44 B.T.A. 824, 830; Fruit Growers Supply Co., 21 B.T.A. 315, 326, affirmed, 56 F. 2d 90; and Farmers Cooperative Co. v. Birmingham, (N. D. Iowa) 86 F. Supp. 201.

"The judicial authorities and administrative rulings indicate that, in order for an allocation of earnings by a cooperative association to qualify as a true corrective and deferred price adjustment, and hence as a true patronage dividend, at least three prerequisites must be met: First, the allocation must have been made pursuant to a preexisting legal obligation; that is to say, it must have been made pursuant to a legal obligation which existed at the time the participating patrons transacted their business with the cooperative, and not pursuant to an obligation created after the allocated amount was earned. 4/ Southwest Hardware Co., 24 T.C. 75, 82. Second, the allocation must have been made out of profits or income realized from transactions with the particular patrons for whose benefit the allocations were made, and not out of profits or income realized from transactions with other persons or organizations which were not entitled to participate in such allocations. Clover Farm Stores Corporation, supra, 1277; Valpariso Grain & Lumber Co., 44 B.T.A. 125, 126, 127; Regs. 45, Art. 522; I.T. 1499, supra;

4/ The parties have stipulated that, in the instant case, this prerequisite has been met.

A.R.R. 6967, supra; S.M. 2595, supra; G.C.M. 12393, supra.Rev. Rul. 57-59, supra. And third, the allocations must have been made equitably; so that profits realized on the one hand from selling merchandise or services to patrons, and those realized on the other hand from marketing products purchased from patrons, were allocated ratably to the particular patrons whose patronage created each particular type of profit. See I.T.1499,supra; I.T. 3208, supra; Clover Farm Stores Corporation, supra; Farmer Cooperative Co. v. Birmingham, supra; See also, George J. Waas and Daniel G. White, "Application of the Federal Income Tax Statutes to Farmers' Cooperatives" (November 1942), Farm Credit Administrative Bulletin No. 53, page 70.

"With further regard to the second and third of such prerequisites, it is to be observed that the only references to patronage dividends of cooperatives, made in the Internal Revenue Codes of 1939 and 1954, indicate that the principles governing the allowance of such patronage dividends are the same, in the case of tax-exempt cooperatives and in the case of non-exempt cooperatives; for, as hereinbefore noted, section 101 (12)(B) of the 1939 Code and section 522(b)(2) of the 1954 Code each provides that 'Patronage dividends, refunds and rebates to patrons with respect to their patronage * * * shall be taken into account in computing the net income [of a tax-exempt cooperative] in the same manner as in the case of a cooperative not exempt * * *.' [Emphasis supplied] And, under section 101 (12)(A) of the 1939 Code and section 521 of the 1954 Code, the only tax-exempt cooperatives to whom allowances for patronage dividends may be made, are those which, in respect of their marketing activity, turn back to their marketing patrons the net profits of such activity, 'on the basis of either the quantity or the value of the products furnished by them'; or which, in the case of their activity in selling supplies and equipment to their patrons, turn over such supplies and equipment 'to them at actual cost, less necessary expenses.'"

The court said it could find no statutory or judicial authority to support the allocation made by the taxpayer. It distinguished Greene County Farmers Sales Association v. United States, (Ct.Cls.) 55 F. Supp. 123, relied on by taxpayer, and deemed unauthoritative an unpublished letter from a deputy commissioner of internal revenue to a taxpayer other than this taxpayer.

Of prime significance is the Court's definition of an "excludable" patronage refund and the emphasis placed on the point that patronage refunds must be allocated equitably to

the particular patrons with whom the business was transacted that gave rise to the refunds. It will be especially noted that this part of the opinion applies to all farmer cooperatives, whether or not they qualify for limited exemption under section 521 of the Internal Revenue Code of 1954.

On this matter of equality of treatment, the court said the association had not acted properly in allocating receipts from storage business since it (1) had included some patrons who had not furnished such business, and (2) had not used a proper basis of allocation, since it made the allocation on bushels and included, in addition to bushels stored, the number of bushels which its members had delivered either for sale to the elevator or surrender to Commodity Credit Corporation. The court held that margins on storage should have been allocated to only those members who participated in storage and then only in the proportion that their storage business bore to the total member storage business receipts, less the necessary expenses applicable thereto.

The following excerpts from the opinion cover this point:

"As to the third class of compensation above mentioned, this represents amounts received by petitioner from its members, for storing grain owned by such members. It is our opinion that, under the principles above stated, allocations out of such compensation, if made equitably to the particular members from whom the compensation was received, would qualify as true patronage dividends.

"Petitioner, however, allocated the compensation falling within this third class, not with regard to the amounts of storage business transacted with the particular members for whose benefit the allocations were made, but rather with respect to the number of bushels of grain which its members had delivered to its elevator, either for purchase by petitioner or for surrender to the C.C.C. in satisfaction of Government crop loans. The particular members with whom this storage business was transacted are not shown to compose the entire group of members who delivered grain to petitioner's elevator for the other purposes stated above. Indeed, over 94 per cent of the stored grain consisted of soybeans; while on the other hand, most of the grain delivered to petitioner's elevator for the other purposes above mentioned was corn. Also, the amounts of business done by these two groups of members have not been shown to have produced profits which were allocable at the same rates. Accordingly, the petitioner, in making the allocations out of the third class of storage income failed in part to meet the third prerequisite above mentioned.

"We hold that the amounts allocated to members only, out of compensation received from members for storing grain owned by them, are excludible from petitioner's gross income as part of its patronage dividends, only to the extent that the amounts which were allocated to the particular members who stored grain, represented their proportionate shares of total member storage business which produced the compensation of such class, less the necessary expenses applicable thereto."

It is suggested that it would be prudent for all cooperatives to examine their bylaw provisions and patronage refund practices in the light of this decision. Some operations may need further departmentalization to assure that patrons will share equitably in only such margins as their business helps to produce.

Following this decision, a number of additional cases, involving similar facts, have also been decided. These, as of the time this report was prepared, were as follows:

1. Alleman Cooperative Co. v. Commissioner, Dkt. 64979, January 23, 1959, T.C.Memo. 1959-10; C.C.H. Dec. 23,418(M)
2. Bradgate Cooperative Exchange v. Commissioner, Dkt. 64629, January 28, 1959, T.C.Memo 1959-11; C.C.H. Dec. 23,426(M).
3. Farmers Cooperative Elevator v. Commissioner, Dkt. 65360 January 29, 1959, T.C.Memo. 1959-12; C.C.H. Dec. 23,429(M)
4. Farmers Cooperative Elevator Co. v. Commissioner, Dkt. 64898, January 29, 1959, T.C. Memo 1959-13; C.C.H. Dec. 23,430(M)
5. Farmers Cooperative Co. v. Commissioner, Dkt. 66167, January 29, 1959, T.C.Memo. 1959-14; C.C.H. Dec. 23,431(M)

ANTITRUST LAW - AGRICULTURAL COOPERATIVE'S BUSINESS ACQUISITION CONTRACT HELD VIOLATION OF SECTION 3 OF SHERMAN ACT; DIVESTITURE ORDERED

(United States v. Maryland & Virginia Milk Producers Association, Inc., U.S.D.C. for D.C., Civil No. 4482-56, January 14, 1959 and January 22, 1959.)

In a third oral decision in this case, the judge held that the contract by which the cooperative had acquired the assets of Embassy Dairy, Inc., and the ancillary contracts to such acquisition "were and are in violation of section 3 of the Sherman Act (15 U.S.C. §3)". This disposed of the so-called "second count", which was in the case, as set out in the earlier report on this case (Summary of Cooperative Cases, Legal Series No. 7, p. 46 et seq.). On January 22, 1959, judgment was entered ordering the association to dispose of the assets it acquired from Embassy Dairy, Inc., within one year. Since both sides are appealing directly to the Supreme Court, a stay of this judgment was entered on January 30, 1959, until the appeal is concluded.

In the third opinion, the court summarized what had gone before (see earlier report cited above) and then said:

"It was stipulated that the case, insofar as this cause of action was concerned, would be submitted on the same record as that before the Court at the trial on the first and third causes of action.

"The Court, therefore, readopts the findings of fact that it has heretofore made.

"In addition to that, it is going to make a few additional findings, largely of the nature of ultimate findings based upon the evidentiary findings heretofore made.

"First, the Court finds as a fact that the result of the transaction complained of was a foreclosure of competition, in respect to Government contracts and in respect to purchases of milk from milk producers.

"The Court further finds as a fact that the transaction complained of was entered into with the intent and purpose of restraining trade.

In the light of the decision of the Supreme Court in United States v. Griffith, 334 U.S. 100, 105, the Court does not regard

it as necessary to find a specific intent to restrain trade in order to reach the conclusion of law that the anti-trust laws have been violated. Nevertheless, the Court does make hereby such a finding of fact.

"The Court further concludes that an unreasonable restraint of trade, violative of the Sherman Act, has resulted from the acquisition of Embassy Dairy by the Defendant.

"It has been urged in behalf of the Defendant that the transaction involved in this case is within the immunity accorded to agricultural cooperatives. The basis of this argument is that the doctrine which bans immunity in respect to transactions entered into between agricultural cooperatives and organizations that are not such cooperatives should be limited to such transactions as result in a competitive advantage to the other party to the transaction, that is, the party which is not clothed with the immunity.

"The Court does not find any authoritative basis for such a distinction. The general doctrine limiting the immunity in the manner heretofore stated was formulated and enunciated by the Supreme Court in United States v. Borden Company, 308 U.S. 188, 204.

"There is nothing in that case intimating that any such limitation as is now suggested should exist. This Court finds no authoritative or binding expression formulating such a qualification.

"True, some expressions are cited from a number of District Court cases involving transactions of labor unions which tend to support the reasoning advanced on behalf of the Defendant in this respect.

"Entirely aside from the fact that those expressions are not binding on this Court, it must be noted that the decisions involving labor union transactions are governed by a somewhat different principle than those which apply to agricultural cooperatives.

"To be sure, the same provision of law grants an immunity from the anti-trust laws to agricultural cooperatives as to labor unions; but in addition to that, other statutes, such as the Norris-La Guardia Act, and the National Labor Relations Act, the Labor-Management Act, add certain additional privileges to labor unions that are not accorded to agricultural cooperatives.

It necessarily follows, therefore, that decisions involving labor unions are not necessarily apposite as to this point when an agricultural cooperative is involved.

"In this connection, it is appropriate to call attention to the decisions of the Supreme Court in United States v. Hutcheson 312 U.S. 219, and in Allen Bradley Company v. Local Union No. 3, 325 U. S. 797, 806, in which it was held expressly that:

'The Sherman Act, the Clayton Act and the Norris-La Guardia Act must be jointly considered in arriving at a conclusion as to whether labor union activities run counter to the anti-trust legislation.'

"Naturally, an agricultural cooperative can derive no benefit from the statutes relating to labor unions.

"The Court, therefore, reaches the conclusion that the statutory immunity accorded to agricultural cooperatives does not apply to the transaction here involved.

"In respect to the main issue here presented for decision, it has been held by the Supreme Court that it is unreasonable per se to foreclose competitors from any substantial market. International Salt Company v. United States, 332, 396; United States v. Griffith, 334 U.S. 100, 107.

"In addition, the case of United States v. Yellow Cab Company, 332 U.S. 218, generally supports the conclusion that is being reached here.

"The Court concludes that the transaction involving the acquisition of Embassy Dairy by the Defendant constitutes a violation of Section 3 of the Sherman Act."

The final judgment is concise and in general terms. The pertinent paragraphs read as follows:

"1. The acquisition by defendant of certain assets of Embassy Dairy, Inc. on or about July 26, 1954, and the contracts ancillary thereto, were and are in violation of Section 7 of the Clayton Act (15U.S.C.§18).

"The acquisition by defendant of the capital stock of Richfield Dairy Corporation, and Simpson Brothers, Inc., trading as Wakefield-Model Farms Dairy, was not and is not in

violation of Section 7 of the Clayton Act and the cause of action relating thereto is dismissed with prejudice.

"3. The contract of May 26, 1954, pursuant to which defendant acquired certain assets of Embassy Dairy, Inc., and the ancillary contracts were and are in violation of Section 3 of the Sherman Act (15 U.S.C.§3).

"4. Within one (1) year from the date hereof the defendant shall dispose of as a unit and as a going dairy business all assets of Embassy Dairy, Inc., tangible and intangible, which it acquired on July 26, 1954, and replacements therefor.

"5. The divestiture herein ordered shall be in good faith and shall require the prior approval of this Court on notice to counsel for the plaintiff. Within sixty (60) days from the date hereof, the defendant shall report to the Court its efforts to carry into effect the divestiture herein ordered. Further reports shall be made to this Court every 90 days thereafter and on such other dates as this Court may order.

"6. Pending divestiture, defendant shall administer the assets acquired from Embassy Dairy, Inc., and replacements therefor in good faith as a going dairy business with a view to preserving the said assets in as good condition as possible, ordinary wear and tear excepted. For legitimate business purposes, present assets may be replaced by other assets of substantially equal value. If deemed advisable in the operation in good faith of the said dairy business, capital improvements may be made. The sale of any capital asset of a value in excess of $10,000 shall require the prior approval of the Court.

"7. So much of the contracts by and between defendant and Embassy Dairy, Inc., Green Spring Dairy, Inc., Green Spring Milk Company, Homestead Dairy Products Company, James J. Ward, James J. Ward, Jr., John Ward and R. Jeanne Ward, respectively made on or about May 26, 1954, as provide that for a period of ten years the aforementioned persons will not engage in the sale or distribution of milk, cream or other dairy products in an area consisting of the District of Columbia and adjacent parts of the States of Maryland and Virginia, are hereby declared invalid and defendant is enjoined and restrained from enforcing or claiming any rights under such provisions.

"8. Jurisdiction of the causes of action stated in Paragraph 29 and Paragrpahs 24 and 28, inclusive, of the Complaint as amended is retained for the purpose of enabling either of the

parties to apply to this Court at any time for such further order and directions as may be necessary or appropriate for the construction or carrying out of this Final Judgment and for the enforcement of compliance therewith and punishment of violations thereof.

"9. Neither party shall be allowed costs."

EVIDENCE NOT SUFFICIENT TO SUPPORT FINDING THAT EMPLOYER WAS GUILTY OF UNFAIR LABOR PRACTICE.

(National Labor Relations Board v. Winter Garden Citrus Products Cooperative, C.C.A. 5th, 260 F. 2d 913, 1958)

In proceedings for enforcement of an order of the National Labor Relations Board, the Fifth Circuit Court of Appeals found that the record did not contain substantial evidence to support findings that the cooperative was guilty of violations of the National Labor Relations Act by refusing to bargain with a union in regard to certain matters noted below.

The Board asserted and sought to maintain that the co-op(1) had violated Sections 8(a)(3) and (1) of the National Labor Relations Act by discriminatorily refusing to hire 26 job applicants because of their union membership or activity; and (2) had violated Section 8(a)(5) and (1) of the Act by refusing to bargain with the union, first by refusing to recognize certain union stewards for the purpose of settling grievances, and second by refusing to furnish information with respect to certain year-end gratuities it had paid.

The Court pointed out that, in proceedings of this kind, the burden of showing non-compliance is always on the Board. It held that the evidence in this case, being all circumstantial, except for some discredited findings in an earlier case, was not adequate to prove unfair hiring practices.

With regard to the charge of failing to bargain about bonuses, the co-op insisted that there was no bargaining session going on at the time of the request for information regarding gratuities

which had been conferred in private on a few as a bounty or reward for actions or conduct beyond the call of duty, and that, in any event the few gratuities distributed were not "bonus payments". The court agreed.

As to the complaint about the stewards, the court also agreed that the record supported the claim of the Cooperative; namely - that the setting up of the stewards was a mere temporary device until a contract could be signed; that their use was never embodied in a contract, nor was any contract arrived at, and it was, therefore, not an unfair labor practice not to continue their use.

Enforcement of the Board's order was denied.

"DEMOCRATIC CONTROL" DESCRIBED FOR PURPOSES OF DETERMINING EXEMPT STATUS OF MUTUAL INSURANCE COMPANIES

(Rev. Rul. 58-616; I.R.B. 1958-51, p. 49)

"Whether democratic control is in the policyholders of a mutual insurance company depends on the circumstances of each case and is determined by the control which the policyholders actually exercise, to the exclusion of any group other than policyholders, and not upon the unexercised power to control which such other group has by statute or otherwise.

"Revenue Ruling 55-240, C.B. 1955-1, 406, clarified.

"Reconsideration has been given to Revenue Ruling 55-240, C. B. 1955-1, 406, relative to mutual insurance companies, in view of the decisions in Holyoke Mutual Fire Insurance Company v. Commissioner, 28 T.C. 112; Citizens Fund Mutual Fire Insurance Company v. Commissioner, 28 T.C.1017; and Property Owners Mutual Insurance Company v. Commissioner, 28 T.C. 1007, acquiescences, page 6 this Bulletin.

"In the Holyoke, Citizens Fund and Property Owners cases, supra, the Tax Court of the United States held that the companies therein, chartered as mutual companies, were taxable as such under section 207 of the Internal Revenue Code of 1939 (section 821 of the Internal Revenue Code of 1954) even though each had guaranty fund certificates outstanding. The court emphasized the fact that, since the term "mutual insurance company" is not

defined in the 1939 Code, or in Regulations 118 with respect thereto, the classification of an insurance company as a mutual or a stock company depends on the circumstances of each case. One of the most important factors in making this determination relates to democratic ownership and control of the company by the policyholders which is as equally a fundamental characteristic of a mutual insurance company as the company's furnishing insurance to the policyholders substantially at cost. Keystone Automobile Club Casualty Co. v. Commissioner, 122 Fed (2d) 886, at 889 and 890, certiorari denied, 315 U.S. 814.

"Revenue Ruling 55-240 holds that, in the absence of democratic control by the policy members, an insurance company may not qualify as a mutual insurance company taxable under the provisions of section 207 of the 1939 Code. It is the position of the Internal Revenue Service that whether democratic control is in the policyholders of a mutual insurance company depends on the circumstances of each case and is determined by the control which the policyholders actually exercise, to the exclusion of any group other than policyholders, and not upon the unexercised power to control which such other group has by statute or otherwise. On the facts presented in Revenue Ruling 55-240, there was insufficient evidence to establish that the policyholders had democratic ownership and control, and as a consequence, the taxpayer could not qualify as a mutual insurance company.

"Revenue Ruling 55-240, C.B. 1955-1, 406, clarified."

This ruling may be of some analogous force in considering whether a farmer cooperative may be said to have "substantially all" its stock owned by producers who actually market or purchase their supplies through the association; one of the requirements for qualification under section 521 of the Internal Revenue Code of 1954.

PATRONAGE REFUNDS; CLASS B STOCK OF FEDERAL INTERMEDIATE CREDIT BANKS

The South Carolina Tax Commission, by letter dated January 12, 1959, has ruled that production credit associations operating in the State are not required to include in their income for State income tax purposes patronage refunds received by them in the form of class B stock of the Federal Intermediate Credit Bank of Columbia. The ruling is on the premise that such stock has no present market value. However, the ruling points out that the value of the stock may become taxable in the future when such stock is redeemed or becomes transferable for value, or is retired or cancelled by the Federal intermediate credit bank.

LABOR DISPUTE; WHAT CONSTITUTES FURTHERANCE OF A LEGITIMATE LABOR PURPOSE

(<u>Consumer-Farmer Milk Cooperative, Inc.</u>, v. <u>Milk Drivers and Dairy Employees Local No. 584</u>, 177 N.Y.S. 2d 889 (1958))

In this case action was brought by a milk cooperative to declare that a clause in a collective bargaining agreement negotiated with a union and several groups of employers was invalid as constituting a conspiracy with other milk sellers to hamper sale of milk by the cooperative. The cooperative moved to temporarily restrain the union from any act compelling the milk company to enter into the agreement pending trial. At a special term of the Supreme Court, Judge Aron Steuer held that the issue of whether the disputed clause was in furtherance of a legitimate labor purpose could not be resolved upon affidavits and since nothing had been done or threatened in the way of a strike or picketing of plaintiff company, motion for temporary relief would be denied without prejudice to renewal of application should the situation change adversely.

The contract offered to plaintiff by defendant union contained a clause, 62-A, which made it a violation to sell or distribute milk from wholesale trucks. An exception was made for settlement houses. Settlement houses were limited to those mentioned in a schedule and it was further provided that if the

location ceased to qualify as a settlement house, the location should be stricken. Plaintiff objected to this clause as a restriction which the other dealers and unions had no right to make as it could effectually put plaintiff out of business. It was agreed that the matter be submitted to arbitration before an arbitrator of national distinction. John T. Dunlop was selected as arbitrator and in due course rendered his decision. Professor Dunlop refused to decide the issue raised by plaintiff considering it more appropriate for legal action. He changed the clause to include nurseries and other charitable institutions and to cover changes in locations of existing institutions. The new contract offered to plaintiff by defendant union contained a clause in the wording of the Dunlop award. Plaintiff has objected and refused defendant's offer to arbitrate the question. The union has replied that it will take whatever steps it deems advisable.

The action sought a declaration that Clause 62-A was void as against Article 22 of the General Business Law and to restrain the defendant from engaging in a conspiracy with other milk sellers to hamper the sale of milk by plaintiff and particularly to restrain defendant from doing any act to compel plaintiff to enter any agreement containing such clause.

The court observed that the main issue was whether this is a labor dispute. That in turn depends on whether the inclusion of the clause is in furtherance of a legitimate labor purpose or whether it is the consequence of agreement between the other milk dealers and the unions who represent their employees to hamper and restrain plaintiff in order to do away with the competition plaintiff's activities afford. He said; "Merely stating this question shows that it is one of great extent which does not lend itself to resolution upon affidavits."

Accordingly, and since the union had taken no action injurious to the plaintiff, the application for temporary relief was denied.

TRADE-MARKS; INJUNCTION RESTRICTING USE OF "SUN-MAID" EXCEPT ON SPECIFIED RAISIN PRODUCTS CONTINUED IN FORCE.

(California Packing Corporation v. Sun-Maid Raisin Growers of California, S.D. Cal. N.D., 165 F. Supp. 245 (1958))

This was a proceeding by Sun-Maid Raisin Growers of California in which it sought to have dissolved an injunction which had been entered against it in 1936 and which restrained it from using the trade-mark "Sun-Maid" except on specified raisins and raisin products.

One of the grounds urged was that the California Packing Corporation which obtained the injunction and which had sued Sun-Maid originally alleging infringement of its "Sun-Kist" trade-mark, had since assigned that trade-mark to Sunkist Growers, Inc., which was now using the mark in the unhyphenated form of "Sunkist". The court held, however, that this was not a proper ground for dissolving the injunction. Original litigation between the parties in New York prior to 1936 had been based on contentions relating to the Sun-Kist mark and its infringement. However, the litigation in 1936 related to a contract by which Sun-Maid's predecessor had compromised a lawsuit and, in so doing, had in 1917 entered into a contract with California Packing Corporation agreeing to restrict its use of the mark. The injunction, according to the court, was merely confirmatory of the contract. Accordingly, under the guise of trying to modify the injunction, Sun-Maid was really trying to be relieved of the contract which its predecessor had entered into and by which it is still bound. The court said it would not do equity, but, on the contrary, would be inequitable, in this manner and without other factual reasons to relieve the defendant of the binding effect of the contract.

It was also charged in the suit that the contract was invalid because it was monopolistic. On this charge the court said,in part:

> "The present trend of the courts is not to consider control of a commodity in itself as constituting a monopolistic practice which goes counter to the Sherman Anti-Trust Act unless the control of the market is such that the public has no access to competitive commodities. The Supreme Court in United States v. E. I. du Pont de Nemours & Company, 1956, 351 U.S. 377, 394, 76 S.Ct. 994, 1006, 100 L.Ed. 1264 stated the problem in this manner:

'* * * When a product is controlled by one interest, without substitutes available in the market, there is monopoly power. * * * But where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist merely because the product said to be monopolized differs from others. If it were not so, only physically identical products would be a part of the market.'

"Even when the right to trade is limited, there is no anti-trust violation in an agreement unless it result in an unreasonable restraint. Restatement, Contracts, §§ 512-513; Apex Hosiery Co. v. Leader, 1940, 310 U.S. 469, 485-486, 497, 60 S.Ct. 982, 84 L. Ed. 1311; Times Picayune Pub. Co. v. United States, 1953, 345 U.S. 594, 611, 73 S.Ct. 872, 97 L. Ed. 1277; Stearns v. Tinker & Rasor, 9, Cir., 1958, 252 F. 2d 589; Klor's, Inc. v Broadway-Hale Stores, Inc., 9 Cir., 1958, 255 F. 2d 214. And see the writer's opinion in Martin v. Ford Alexander Corporation, D.C.Cal. 1958, 160 F. Supp. 670, 686-687."

The court also pointed out that the restriction did not preclude Sun-Maid from producing and selling products competitive to plaintiff's, but only precluded use of the trade-mark except in a specified way.

TENTATIVE REGULATIONS ON PATRONAGE DIVIDENDS RECEIVED FROM COOPERATIVE ASSOCIATIONS

The proposed regulations on the foregoing subject were published in the Federal Register for Wednesday, March 11, 1959, at pages 1750 and 1752. Interested persons have a period of thirty (30) days from such date to file written comments or suggestions. The essence of the proposed rules is contained in the following excerpt:

"(b) Extent of taxability. (1) Amounts allocated to a patron on a patronage basis by a cooperative association with respect to products marketed for such patron or with respect to supplies, equipment, or services, the cost of which was deductible

by the patron under section 162 or section 212, shall be included in the computation of the gross income of such patron, as ordinary income, to the following extent:

(i) If the allocation is in cash, the amount of cash received.

(ii) If the allocation is in merchandise, the amount of the fair market value of such merchandise at the time of receipt by the patron.

(iii) If the allocation is in the form of capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or similar documents, the amount of the fair market value of such document at the time of its receipt by the patron. For the purposes of this subdivision, capital stock and any document containing an unconditional promise to pay a fixed sum of money on demand or at a fixed or determinable time shall be considered to have a fair market value at the time of its receipt by the patron. However, any revolving fund certificate, retain certificate, letter of advice, or similar document, which is payable only in the discretion of the cooperative association, or which is otherwise subject to conditions beyond the control of the patron, shall be considered not to have any fair market value at the time of its receipt by the patron.

(2) If any allocation to which subparagraph (1) of this paragraph applies is received in the form of a document of the type described in subparagraph (1)(iii) of this paragraph and is redeemed in full or in part or is otherwise disposed of, there shall be included in the computation of the gross income of the patron, as ordinary income, in the year of redemption or other disposition, the excess of the amount realized on the redemption or other disposition over the amount previously included in the computation of gross income under such subparagraph.

(3)(i) Amounts which are allocated on a patronage basis by a cooperative association with respect to supplies, equipment or services, the cost of which was not deductible by the patron under section 162 or section 212, are not includible in the computation of the gross income of such patron. However, in the case of such amounts which are allocated with respect to capital assets (as defined in section 1221) or property used in the trade or business within the meaning of section 1231,

such amounts shall, to the extent set forth in subparagraph (1) of this paragraph, be taken into account by such patron in determining the cost of the property to which the allocation relates. Notwithstanding the preceding sentence, to the extent that such anounts are in excess of the unrecovered cost of such property, and to the extent that such amounts relate to such property which the patron no longer owns, they shall be included in the computation of the gross income of such patron.

(ii) If any patronage dividend is allocated to the patron in the form of a document of the type described in subparagraph (1)(iii) of this paragraph, and if such allocation is with respect to capital assets (as defined in section 1221) or property used in the trade or business within the meaning of section 1231, any amount realized on the redemption or other disposition of such document which is in excess of the amount which was taken into account upon the receipt of the document by the patron shall be taken into account by such patron in the year of redemption or other disposition as an adjustment to basis or as an inclusion in the computation of gross income, as the case may be.

(iii) Any adjustment to basis in respect of an amount to which subdivision (i) or (ii) of this subparagraph applies shall be made as of the first day of the taxable year in which such amount is received."

The foregoing excerpt omits examples illustrative of the application of the regulations. The proposed regulations also contain the following special rule:

"(c) Special rule. If, for any taxable year ending before the date of publication of this paragraph as final regulations in the FEDERAL REGISTER, a taxpayer treated any patronage dividend received in the form of a document described in paragraph (b)(1)(iii) of this section in accordance with the regulations then applicable (whether such dividend is subject to paragraph (b)(1) or (3) of this section), such taxpayer is not required to change the treatment of such patronage dividends for any such prior taxable year. On the other hand, the taxpayer may, if he so desires, amend his income tax returns to treat the receipt of such patronage dividend in accordance with the provisions of this section, but no provision in this paragraph shall be construed as extending the period of limitations within which a claim for credit or refund may be filed under section 6511.